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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1961

No. 736

WHITEFISH LUMBER COMPANY

Petitioner

vs.

INDUSTRIAL SUPPLY CO., PACIFIC POWER AND LIGHT COMPANY, ROLIE'S MACHINE WORKS, KALISPELL MERCANTILE CO., AND FRANCIS POULSON,

Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Opinions Below

The opinion of the United States District Court of the District of Montana is not reported, and is appended hereto as Appendix A. The opinion of the United States Court of Appeals For the Ninth Circuit is not reported, and is appended hereto as Appendix B.

Grounds For Jurisdiction

This petition seeks review of the order of the Court of Appeals dated and entered November 2, 1961. Petition for rehearing was denied by the Court of Appeals by order dated December 14, 1961. There has been no extension of time within which to file this petition.

This court has jurisdiction to review the judgment of the Court of Appeals by virtue of 11 U.S.C., Sec. 47.

Question Presented

The question presented for review is: In determining whether the giving and filing of a chattel mortgage in renewal of a previous chattel mortgage as to which the statutory period for filing affidavit of renewal has expired is a preferential transfer constituting an act of bankruptcy, must the bankruptcy court resolve the question of whether, under the law of the state, such transaction amounts to a mere exchange of securities or is the giving of an entirely new security?

Statutes Involved

The federal statutes involved are provisions of the Bankruptcy Act, as follows:

> " 'Transfer' shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge, mortgage, lien, encumbrance, gift, security, or otherwise; the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor." (11 U.S.C. §1(30))
>
> "§60. **Preferred Creditors.** a. (1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four

months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

"(2) For the purpose of subdivisions a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee. . ." (11 U.S.C. §96)

The provisions of the statutes of the State of Montana involved are as follows:

"**Duration of Liens.** Every mortgage of personal property, made, acknowledged, and filed, as provided by the laws of this state, is thereupon, if made in good faith, good and valid as against the creditors of the mortgagor, or subsequent purchaser, or encumbrancers, from the time it is so filed, and for a period of two years and sixty days thereafter. A mortgage of personal property, executed and filed as hereinbefore provided, ceases to be valid as against creditors of the mortgagor or subsequent purchaser or encumbrancer in good faith, after the expiration of two years and sixty days from the filing thereof, except as hereinafter provided." (Section 52-305, Revised Codes of Montana of 1947)

"**Renewal of mortgages-affidavit.** Every mortgage of personal property, executed and filed as provided by the laws of this state, may be renewed at any time within sixty days after the expiration of two years from the date of filing the same, in case such debt or obligation, or any part thereof, be unpaid or unfulfilled, by the filing of an affidavit. . . The affidavit must be filed in the office where the mortgage therein described is filed, and thereupon the county clerk of such county must attach such affidavit to the mortgage therein described, and note the date of filing thereof in the book provided by law for the

entry of chattel mortgages, and the original mortgage shall then continue in full force and effect for the period of three years from the date of filing said affidavit" (Section 52-306, Revised Codes of Montana of 1947; since amended)

Statement of the Case

Petitioner borrowed money for plant expansion, giving the lender, Walter E. Heller & Company, on April 16, 1956, a chattel mortgage in security, which the lender filed for public record on April 26, 1956. The mortgage required monthly payments with final maturity three years from date of the mortgage. The maturity date thus provided for was beyond the date provided by the above cited Montana statute as the date for the expiration of the lien without going through the statutory renewal procedure. The period within which the renewal procedure could be taken expired on June 25, 1958 without the lender having taken the statutory steps for renewal. The lender thereafter discovered its oversight and demanded of the petitioner the execution of a new chattel mortgage, describing the same property and securing the same note as the original mortgage. Petitioner complied, and on July 12, 1958, executed and delivered such new mortgage, which the lender filed in the same office on July 15, 1958.

On November 12, 1958, certain creditors having debts against the petitioner, all of which debts arose prior to the expiration date of the original mortgage (Transcript, p. 44), filed a petition with the U. S. District Court, District of Montana, for the adjudication of the petitioner as an involuntary bankrupt, alleging that the mortgage of July 15th constituted a preferential transfer, given to secure an antecedent debt. Other preferential transfers were also alleged, but the adjudication of bankruptcy concerned only the above mentioned mortgage. (Transcript, pp. 74-75, 84-85).

Shortly thereafter, this petitioner moved for dismissal of the petition for adjudication upon the ground that the petition failed to state a claim in that the mortgage of July 15th was but a continuation of the mortgage of April 16, 1956, which, of course, was given many months more than the four months prior to the filing of the proceedings for adjudication of bankruptcy.

Briefs were filed upon the motion in which the alleged bankrupt maintained, and the petitioning creditors denied, that under Montana law, a chattel mortgage as to which time for renewal has expired was nevertheless valid as against general creditors who had failed to perfect a lien against the property mortgaged prior to the filing of some renewal instrument, and that consequently, there was no "transfer" at all within the meaning of the Bankruptcy Act, the renewal instrument being even in such circumstances a mere continuation of an existing security. It was conceded on both sides that no Montana case had decided the precise point as to whether during the period between the mortgages the original mortgage is valid as against general creditors who failed to perfect a lien before a renewal instrument was filed. Both sides advanced considerable argument in favor of their respective interpretations of what the Montana law on this question might be.

The District Court denied the motion, ruling in its memorandum opinion that whatever the Montana law upon this question might be, it was made immaterial by the 1938 and 1950 amendments to the Bankruptcy Act, specifically the above-cited subparagraph a(2) of 11 U.S. Code, Sec. 96.

Thereafter this petitioner filed answer setting up this and other defenses, and trial was had, rsulting in an adjudication of bankruptcy. Petition for review was denied by the District Court, and appeal was then taken to the

Court of Appeals, both from the adjudication of bankruptcy and the District Court's order denying the motion to dismiss.

Upon the appeal, and especially upon the petitioner's petition for rehearing, the petitioner maintained that it was necessary to determine the law of Montana on the above mentioned question before the bankruptcy court could determine whether, in fact, the July 12th mortgage was a "transfer." The Court of Appeals affirmed the District Court and denied petition for rehearing.

The original jurisdiction of the federal courts is based upon 28 U.S.C., Sec, 1334 and 11 U.S.C., Sec, 1(9)(10) and Sec. 11.

Summary of the Argument

The adjudication below is necessarily based upon a construction of Section 60a(2) of the Bankruptcy Act which discovers an intention by Congress to make immaterial in all instances any reference to state decisions which give validity or priority to mortgages not in strict compliance with the literal wording of the state recording statutes. Neither from the implications of this subsection, nor from the history of the enactment of the Chandler Act, does this sweeping intent appear. Congress intended to deal specifically with the severe injustice of the doctrine which protected certain secret liens against attack as preferential transfers. The finding of an intent by Congress to make all transactions complained of as preferential transfers void if not in strict compliance with the literal wording of the recording statutes not only extends the remedies of general creditors under the bankruptcy act to make void certain secret liens valid under state law, but also extends their remedies so as to give them rights which are a windfall and work a substantial injustice upon innocent mortgage creditors, which injustice would be prevented by following the applicable state decisions.

Argument

I

The striking fact about the proceedings in the district Court and the Court of appeal is, first, petitioner advanced a defense, based on the holding in Schreiber v. Colt, 80 Fed. 2nd 511, that the mortgage of July 12, 1958, was not a transfer at all, and second, in none of the proceedings was this defense ever ruled upon.

Following the Schreiber case, the defense made was that under Montana law, a failure to renew a chattel mortgage did not make the expired mortgage absolutely void, but that under Montana law, there was still some security interest such that the later filing of some renewal instrument even after the statutory period for renewal had expired, was not the giving of a new mortgage, but only the renewal of the old—a mere exchange of security—and consequently not a transfer within the meaning of Section 60a of the Bankruptcy Act.

To answer this question, the petitioner maintained, it was necessary for the bankruptcy court to determine whether the Montana statute above cited was of such nature as to give the mortgagee some security even though the filing period had expired, or whether the failure to renew the mortgage within the statutory period rendered it absolutely void.

In favor of its contention, petitioner cited to those courts 10 Am Jur, CHATTEL MORTGAGES, p. 795, the annotation at 51 ALR 603-604, Isbell v. Slette, 52 Mont. 156, 155 Pac. 503, Security State Bank v. First National Bank, 78 Mont. 389, 254 Pac. 417, and First National Bank of Columbus v. Coit, 79 Mont. 468, 257 Pac. 469. Also cited in favor of petitioner's interpretation of Montana law was the interpretation given to the very similar law in Colorado by Schreiber v. Colt, in circumstances virtually identical to the case at bar.

The District Court refused to give this defense any standing, stating in its Memorandum Opinion (Appendix A),

> "Both parties, while admitting that there are no Montana cases in point, have devoted much space in their briefs discussing what the Montana rule on this and related questions might be. However, it does not appear to me that this question is material to the issue before the court at this time. Both parties base their arguments on the premise that under the Bankruptcy Act it makes a difference whether or not a mortgage for which the time for renewal has expired is valid as against subsequent general creditors who have taken no steps to obtain a lien by legal proceedings. This premise is not correct. The parties have failed to consider the effect of the 1938 and 1950 amendments to Section 60a."

The Court of Appeals has concurred in this ruling and theory.

Thus the rule in the Ninth Circuit is now that the 1938 and 1950 amendments to Section 60a of the Bankruptcy Act have made immaterial an inquiry into the effect of a renewal instrument under state law. State law will be invesigated only to determine the mechanical filing and recording steps which result in the perfection of a lien. Out of the Congressional history of these amendments, the Ninth Circuit has discovered an intent to so change the bankruptcy law that whenever a case involves a preferential transfer, the **only** aspect of state which is of interest to the bankruptcy court is the date on which the alleged transfer becomes "perfected."

The petitioner does not maintain that Congress is without power to so enlarge the rights and remedies of general creditors. It plainly has done so to a considerable extent in the 1938 and 1950 amendments by excluding, in certain cases, a consideration of the state law. By requiring the bankruptcy courts to look to the date of perfecting a lien, liens and mortgages valid under the

state law become, in some cases, void under the federal law.

The petitioner does argue that Congress did not exercise its undoubted power to the extent claimed by the District Court and the Court of Appeal. The core of the petitioner's argument is that Congress intended to deal with a specific evil which arose out of certain aspects of the recording laws, and that it did not deal with this evil by burning down the house in order to roast a marshmallow.

II.

Section 60a(2) contains within itself the key to its scope and limitation. It plainly states that a transfer is deemed as made or suffered ". . . at the time when it became so far perfected . . ." The sole concern of the subsection is to define a date which will commence the running of the preferential transfer period.

The full report of the House Committee upon the Chandler Act (Analysis of H.R. 12889, 74th Cong., 2nd Sess. (1936) 188) is not available to the writer. However, the lengthy excerpt which appears at 4 Remington on Bankruptcy, pp. 191-192, sets forth as the great concern of the committee the problem of the pocket lien and the doctrine prior to 1938 which gave validity to unrecorded liens which had validity under the state law from the date of execution. It does not appear from this excerpt that there was any intention to do more than to fix an event of public or formal notice as being the **time** for the computation of the four-month period. Neither the memorandum opinion of the District Court nor the opinion of the Court of Appeals discloses where or how the Congressional intent was found, other than an intention to circumscribe the effect of the authorities relied upon in Schreiber v. Colt.

Insofar as the authorities cited in Schreiber v. Colt support and follow the doctrine of ascribing validity to a lien wholly to its effect under applicable state law, then it certainly is without question that the 1938 and 1950 amendments did intend to circumscribe their effect.

However, Schreiber v. Colt undeniably stands for something in addition to this "relation back" dictrine. It stands also for the proposition that a transaction which has the surface appearance of a "transfer" may in fact, under the surrounding circumstances, not be such, and that the determination of this question must be solved by the application of the relevant state law.

To the same effect as Schreiber is In Re Brayton, 276 Fed. 1020. It reached a different result from Schreiber, but it did so by the identical method—by determining the question of whether or not an expired mortgage was valid when renewed by refering to the effect given to the expired mortgage by the applicable state law.

III.

The Schreiber case is on all fours with the case at bar. There, a chattel mortgage was not renewed within the statutory renewal period and after the oversight was discovered, a new mortgage was obtained and filed. After adjudication of bankruptcy, the renewal mortgage was attacked as preferential. The court held that since the Colorado law was such as to give the mortgage creditor a priority over general creditors who had failed to obtain a lien during the period between the mortgages, the renewal mortgage amounted to a mere continuation of an existing security, and so, not a transfer.

This interpretation of Schreiber is the interpretation given by an eminent bankruptcy authority, where in the text which by footnote refers to Schreiber, it is said,

> "There are certain other situations that should be noted in this connection. For instance, there is no

question but that a chattel mortgage executed and recorded within four months of the mortgagor's bankruptcy for a pre-existing debt will constitute a preferential transfer if the other requisite elements are then present, even though executed pursuant to a prior agreement therefore entered into more than four months before bankruptcy. On the other hand, a chattel mortgage made and recorded during the four months period in renewal or exchange for a valid mortgage previously executed and recorded should not amount to a preference within Sec. 60a."

3 Collier on Bankruptcy, Par. 60.42, pp. 934-935.

Furthermore, interpretations given to Section 60a(2) by this Court since the crucial 1938 amendment indicate that the amendment should have the narrowed scope contended for by this petitioner rather than the all-inclusive scope ascribed by the courts below.

Thus, in Corn Exchange National Bank & Trust Co. v. Klauder, 318 U. S. 434, 87 L. Ed. 884, decided in 1943, this Court considered the voidability as preferences of certain assignments of accounts receivable for failure of the assignees to give notice to the debtors. Although the case was one of those within the secret lien category and so one of the type which the 1938 amendment was specifically proposed to reach, the Court said,

"The Circuit Court of Appeals has determined, and we accept its conclusion, that at all relevant times it was the law of Pennsylvania, where these assignments took place, that because of the failure of these assignees to give notice to the debtors whose obligations were taken, a subsequent good-faith assignee, giving such notice, would acquire a right superior to theirs. It held that the assignments were preferences under Sec. 60(a) and therefore, under the terms of Sec. 60(b), inoperative against the trustee.

"This is undoubtedly the effect of a literal reading of the Act. Its apparent command is to test the effectiveness of a transfer, as against the trustee, by

the standards which applicable state law would enforce against a good faith purchaser." pp. 436-437.

In McKenzie v. Irving Trust Co., 323 U. S. 365, 89 L. Ed. 305, decided in 1945, the question of when a transfer became effective for purposes of Section 60 involved the problem of whether the date to consider was the date on which a certain payment was mailed, or the date on which the creditor received it. The court again decided the question by looking to state law. It said,

> "In absence of any controlling federal statute, a creditor or bona fide purchaser could acquire rights in the property transferred by the debtor, only by virtue of a state law. And hence Sec. 60(a)'s 'apparent command is to test the effectiveness of a transfer, as against the trustee, by standards which applicable state law would enforce against a good faith purchaser'. . . Section 60(a) in this respect, as do numerous other federal statutes . . . . thus adopts state law as the rule of decision. The state standards which control the effectiveness of a transfer likewise determine the precise time when a transfer is deemed to have been made or perfected." p. 370.

There is no doubt that the above two cases can be interpretted as not inconsistent with the rule announced by the Ninth Circuit in the case at bar. However, both cases strongly indicate that all the relevant state law, not merely state law relevant to recording or giving notice, will be applied to solve the particular circumstances. The rule of the Ninth Circuit, however, indicates the opposite, that the bankruptcy courts will go into state law only far enough to inquire as to what recording event or notice giving event makes a transfer "perfected."

Especially the language of McKenzie that "state standards which control the effectiveness of a transfer **likewise** determine the **precise time** a transfer is deemed to have been made of perfected" (emphasis supplied) can only be understood as recognizing two functions of state law in this area: (1) to answer the question of just what

effect, as against other creditors, a given transaction will have, and (2) to determine the date for the commencement of the running of the four-month preferential transfer period.

IV.

The 1938 amendment aimed at correcting a particularly serious vice. Prior to that time, it was possible for a mortgagee to withhold his lien from the public record for an indefinite period of time, state law permitting, giving the mortgagor a false appearance of prosperity which frequently led to extensions of credit by unsuspecting creditors. When the debtor finally appeared in danger of folding, the mortgagee would then file his mortgage and his lien was immune to a suit to set it aside. The situation is radically different in such as the case at bar. In such a situation, the mortgagee records his original mortgage. With access to this knowledge, and knowing of a prior claim by the mortgagee against a fund, the creditors **then** deal with the mortgagor. When the mortgage lien expires by operation of the recording statute, these general creditors are given a sudden windfall—something they did not expect to have, and something which is hard to justify by any equitable principles.

When the mortgagee corrects this situation by filing belated renewal instrument, the situation is merely restored to its former condition—the condition on which the general creditors dealt in the first place. Nobody has **lost** anything; nobody has been misled, as compared to the circumstances on which they originally dealt with the mortgagor.

This Court has long recognized that a windfall of this sort resulting from the technical operation of a recording statute may result in serious injustice. Thus in Patterson v. De La Ronde, 75 U. S. 292, 19 L. Ed. 415, a situation not greatly different from the case at bar had

occurred. The first mortgagee had failed to renew his mortgage, and the second mortgagee, who had taken with prior actual notice of the first mortgage, claimed priority for his mortgage by virtue of the pertinent recording statute which said, concerning recorded mortgages, "their effect ceases even against the contracting parties, if the inscriptions have not been renewed. . . ." Notwithstanding, this Court adopted a construction which held for the priority of the earlier mortgage, saying,

> "It is to the registry, therefore, that purchasers, or others desirous of ascertaining the condition of the property must look, and if not otherwise informed, they can rely on the knowledge there obtained. But if they have knowledge of the existence of unregistered conveyances and mortgages, they cannot, in truth, complain that they are in any respect, prejudiced by the want of registry. In equity, and in this country generally at law, they are not permitted to defeat, under such circumstances, the rights of prior grantees or encumbrancers, but are required to take the title or security in subordination to their rights."

It is likewise the general rule that a defect in recording not apparent on the face of a record does not destroy its effect as a record notice (Annotation at 19 ALR 1079), and that a defective record of an instrument of which a subsequent purchaser has actual knowledge charges him with constructive notice, or otherwise puts him on inquiry to determine the actual state of affairs (19 ALR 1080).

The same care to prevent the technicalities of the recording statutes and their rules of expiration and renewal from working a windfall enrichment to the benefit of **antecedent** creditors and purchasers has resulted in a majority of the state courts having adopted rules which preserve the lien of the mortgagee of the expired or belatedly recorded mortgage as against at least the

antecedent creditors and purchasers who have not secured an attachment or other lien prior to the time he files a renewal instrument, or belatedly records. (See Barber v. Riena Nash Motor Co., 260 Pac 2nd 928).

Exceptions to prevent injustices can themselves become instruments of injustice, and this was the situation with the preferential transfer cases prior to 1938. Congress unquestionably intended to adopt a method of solution which would cut through the various state doctrines which had resulted in such injustice.

But now, in the Ninth Circuit, it is the rule that to get away from this one injustice, Congress in 1938 adopted a measure which swept away not some, but **all**, these various court erected exceptions to the literal readings of the recording acts. In the Ninth Circuit, it can no longer be relevant that an creditor advanced credit with actual knowledge of a prior mortgage. It can no longer be considered that a literal application of the recording statute will work a bitter injustice against a good faith lender, to the enrichment of those who both under the principles of equity and under the painstakingly developed judicial exceptions, would not be entitled to such enrichment.

A cursory glance at the history of Congress's efforts to deal with this prickly problem over the years prior to 1938 is sufficient to discover its care to try to make a rule in bankruptcy which would not destroy the effect of these salutary state doctrines. (See 3 Collier on Bankruptcy, pars. 60.37, 60.38).

Can it be that Congress, in its efforts to correct one injustice to the general creditors, intended to set up a test which now—as in the case at bar—will work as great an injustice upon the mortgage creditor? The Ninth Circuit so holds.

V.

In so holding, the Ninth Circuit places itself squarely and directly in conflict with the Tenth Circuit and the Second Circuit.

It adopts a rule which is in conflict with the underlying theory of this Court in the Corn Exchange and McKenzie cases.

It adopts a rule for which there is no expressed or apparent Congressional intent and which drastically enlarges the evident intent of Section 60a(2), giving to that section an application which creates an injustice as great as the injustice intended to be corrected.

For such reasons, petitioner prays that writ of certiorari issue to the Court of Appeals, and that upon hearing, the cause be remanded to determine whether the alleged preferential transfer was in fact, under Montana law, a transfer at all.

Respectfully submitted,

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APPENDIX A

IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE DISTRICT OF MONTANA
IN BANKRUPTCY

No. 4351

IN THE MATTER OF
WHITEFISH LUMBER COMPANY, a corporation,
Alleged Bankrupt.

MEMORANDUM OPINION

The alleged bankrupt has filed a motion to dismiss the amended petition in bankruptcy, for a more definite statement, and to strike certain portions of the petition. Supporting affidavits are attached to the motion.

The amended petition alleges that Whitefish Lumber Company, a corporation, within four months of the filing of the original bankruptcy petition, while insolvent, executed three chattel mortgages to secure an antecedent debt which would enable the creditor to whom the mortgages were given to obtain a greater percentage of its debt than other creditors of the same class. These chattel mortgages were filed respectively on July 15, September 4, and October 20, 1958. It appears from affidavits filed on behalf of the alleged bankrupt that the chattel mortgages were given in renewal of a previous chattel mortgage filed April 26, 1956, as to which the period for filing the statutory affidavit of renewal had expired. The alleged bankrupt contends that the execution of the new chattel mortgages did not constitute a preferential transfer within the meaning of the Bankruptcy Act.

Section 3 of the Bankruptcy Act (11 U.S.C.A. §21) provides: "a. Acts of bankruptcy by a person shall consist of his having . . . (2) made or suffered a preferen-

tial transfer, as defined in subdivision a of section 60 of the Act . . ."

Section 60a (11 U.S.C.A. §96) provides in part: "a (1) A preference is a transfer . . . of any of the property of a debtor to . . . a creditor for or on account of antecedent debt. made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition . . . the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

"(2) . . . a transfer of property other than real property shall be deemed to have been made or suffered at the time **when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee** . . . (emphasis supplied) (I)f any transfer of other property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition . . . it shall be deemed to have been made immdiately before the filing of the petition.

"(4) . . . A lien obtainable by legal or equitable proceedings upon a simple contract within the meaning of paragraph (2) is a lien arising in ordinary course of such proceedings upon the entry or docketing of a judgment or decree, or upon attachment, garnishment, execution, or like process, whether before, upon. or after judgment or decree and whether before or upon levy . . ."

The basic question is whether the transfer was "so far perfected that no subsequent lien . . . could become superior to the rights of the transferee" at the commencement of the four months period prior to the filing of the petition. This is a question to be determined by the law of the state in which the property is located.

Section 52-305, R.C.M. 1947, reads in part:

". . . A mortgage of personal property, executed and filed as hereinbefore provided, ceases to be valid as against creditors of the mortgagor or subsequent purchaser or encumbrancer in good faith, after the expiration of two years and sixty days from the filing thereof, except as hereinafter provided." Section 52-306 provides for the filing of an affidavit of renewal of a mortgage within sixty days after the expiration of two years from the date of the filing of the mortgage.

It is alleged in the motion to dismiss that the mortgages filed September 4, 1958, and October 20, 1958, were both continuations and renewals of the mortgage security given by a chattel mortgage to Walter E. Heller and Company, (Inc.) filed July 15, 1958, and that all three of the mortgages were continuations and renewals of mortgage security given by the alleged bankrupt more than four months prior to the filing of the original petition. It appears from the supporting affidavits that a chattel mortgage was given by the alleged bankrupt to Walter E. Heller & Company (Inc.), dated April 16, 1956, and filed April 26, 1956. Under Section 52-305 R.C.M. 1947, the lien of this mortgage accordingly expired on June 25, 1958, approximately twenty days prior to the filing of the new mortgage. During that twenty day period, a lien could have been obtained upon the property "by legal or equitable proceedings on simple contract" which would have been superior to the rights of the mortgagee. It appears accordingly that the new or renewal mortgage was a transfer within the meaning of Section 60a of the Bankruptcy Act. In other words, at the commencement of the four-months period the new chattel mortgage was not "perfected" as against liens obtainable by legal and equitable proceedings.

The alleged bankrupt contends, however, that the petitioners, being general creditors, are not "entitled to

claim any rights" under section 52-305; in other words, that a mortgage for which the time for renewal has expired is nevertheless valid as against general creditors as differentiated from lien creditors. There is a conflict of authority on this question. Both parties, while admitting that there are no Montana cases in point, have devoted much space in their briefs discussing what the Montana rule on this and related questions might be. However, it does not appear to me that this question is material to the issue before the court at this time. Both parties base their arguments on the premise that under the Bankruptcy Act it makes a difference whether or not a mortgage for which the time for renewal has expired is valid as against subsequent general creditors who have taken no steps to obtain a lien by legal proceedings. This premise is not correct. The parties have failed to consider the effect of the 1938 and 1950 amendments to section 60a.

The alleged bankrupt relies upon Schreiber vs. Colt, 10 Cir. 1935, 80 F. 2d. 511. Petitioners argue that this case is not in point by reason of differences in the Montana and Colorado statutes, and particularly by reason of the reference in the Colorado statute to "third persons," as defined by the Colorado Supreme Court, without a comparable construction by the Montana Supreme Court of the word "creditors" as used in section 52-305. More fundamental, however, is the difference between the provisions of the Bankruptcy Act in 1935 when this case was decided, and the provisions of section 60a(2), as amended in 1950. The provision presently in 60a(2), that a transfer shall be deemed to have been made "when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings . . . could become superior to the rights of the transferee," was not present in 1935 when the Schreiber case was decided. The comparable provision in 1935 was

the sentence, "Where the preference consists in a transfer, such period of four months shall not expire until four months after the date of the recording or registering of the transfer, if by law such recording or registering is required." The court in the Schreiber case apparently felt that the phrase "if by law such recording . . . is required" pertained to the validity of the mortgage between the parties and not any "third person." Even assuming the correctness of the decision in Schreiber v. Colt, and similar cases, I think the present language of 60a(2) precludes such an interpretation.

The following discussion from 3 Colliers, Bankruptcy pp. 931-933, para. 60.42 is pertinent:

> ". . . the basic test of the preferential character of a chattel mortgage or other transfer of personal property is its 'perfection' as against subsequent judicial liens obtainable by contract creditors of the debtor. The act necessary for such perfection of a chattel mortgage depends generally upon the law of the state where the chattels are situated. . . .
>
> ". . . it was the majority view prior to 1938 that in states where an unrecorded chattel mortgage was good as between the parties and as against general creditors, a chattel mortgage executed for a present or past consideration prior to the four months' period but recorded within four months of the mortgagor's bankruptcy did not constitute a preferential transfer. . . ."
>
> ". . . In these cases it was the general theory that the preferential character of the transfer was to be determined as of the date of execution, not the date of recordation. An opposite result was reached, however, where the state law required recordation before the transfer would prevail over general creditors. . . ."
>
> "The doctrine of these cases as related to preferences . . . was entirely swept away by the 1938 Act, which required the validity of any transfer to be judged as of the date when it was perfected, not only as against subsequent creditors, but also as

against **bona fide** purchasers. While the 1950 amendment discarded the **bona fide** test as to transfers of personal property, it largely effectuates the basic objectives of the 1938 Act in two ways. First, §60a (2) requires perfection of a personal property transfer to the extent that 'no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee.' Second, §60a(3) provides that the lien creditor test shall apply 'whether or not there are or were creditors who might have obtained such liens upon the property.' Together, these provisions eliminate the effect of former holdings that a trustee in bankruptcy could not avoid a transfer perfected as against general creditors, but not as against lien creditors, unless some creditor in the bankruptcy proceeding, whose right could be asserted by the trustee, had actually obtained a subsequent lien against the property transferred."

". . . a chattel mortgage made and recorded during the four months' period in renewal or exchange for a valid mortgage previously executed and recorded should not amount to a preference within §60a.

"But a chattel mortgage given and duly recorded within the four months' period in exchange for an unrecorded mortgage executed prior thereto may amount to a preferential transfer if the necessary elements are present at the recordation of the new mortgage. In this latter case, the rule prior to 1938 varied, dependent on whether recordation of the mortgage was 'required,' that is, necessary as against general creditors of the mortgagor. Now the preferential character of the transaction must be determined at the time when the second mortgage was recorded, if under applicable law (normally state) the transfer would not be good against subsequent lien creditors prior to that time."

One of the purposes of the present section 60 is to strike down secret transfers and lien and at the same time protect the validity of security taken in good faith

in normal business transactions. For example, the provision prescribing the time when a transfer of property shall be deemed to have been made would invalidate liens arising from a mortgage executed prior to the four months' period before bankruptcy but not filed or recorded until within the period, in those states where an unrecorded mortgage would not be valid against a subsequent lien "obtainable by legal or equitable proceedings." It is true that the situation in the instant case poses a slightly different problem in that during the period between the expiration of the mortgage and the filing of the petition, creditors of the alleged bankrupt, would at least have had constructive notice of the prior mortgage and therefore, it is not a secret lien as such. However, after the time for the renewal of the mortgage has expired, a subsequent lien upon the mortgaged property was "obtainable by legal or equitable proceedings on a simple contract" which would have been superior to the rights of the mortgagee under section 52-305. There is nothing in section 60 which would indicate that a different test as to when a transfer is perfected was intended for situations where a chattel mortgage had never been filed and where the statutory period for renewing a previously valid chattel mortgage had expired. Section 52-305 uses the same language, i.e., "creditors of the mortgagor or subsequent purchasers of encumbrancers," in denoting both the persons against whom a filed chattel mortgage is valid, and against whom a mortgage ceases to be valid after the time for renewal has expired. In both instances, the sole test under §60a (2) of the Bankruptcy Act is whether the lien is "so far perfected" that no subsequent lien is obtainable. During the period intervening between the expiration of the lien of the first mortgage and the filing of the new or renewal mortgage, liens were obtainable by legal and equitable proceedings as defined in § 60a(4).

A necessary element of a preference under section 60a is that the "effect of the transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class." In the alleged bankrupt's motion to dismiss it is stated that the mortgages did not have the effect of enabling the mortgagees to obtain a greater percentage of their claims than other "creditors of the same class;" and the motion also seeks a more definite statement as to how the mortgages enabled the mortgagees to obtain a greater percentage than "other creditors of the same class, to-wit, secured creditors."

While there is no reference in the alleged bankrupt's briefs to this specific problem, a clarification is appropriate in view of the language of the motion and the interrelationship of the necessary elements of a preference. In 3 Coliers, Bankruptcy p. 866, para. 60.34, it is stated that the "meaning would be better expressed if the clause read: 'the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than he would be entitled to under the distributive provisions of the Act." If the mortgages in the instant case had not been executed within the four months prior to the filing of the petition, the mortgagees, whose security interests in the property of the alleged bankrupt would have been invalid against the trustee, and the general creditors would have been in the same class with respect to distributions under the Act. It follows that the giving of the mortgages within the four month period while insolvent for an antecedent debt would operate to allow "a creditor to obtain a greater percentage of his debt than some other creditor of the same class" within the meaning of the Act. See 3 Colliers, Bankruptcy, para. 60.34.

I am of the opinion that the amended petition does allege a preference, even assuming the truth of the state-

ments in the affidavits attached to the alleged bankrupt's motion to dismiss to the effect that the mortgage of July 15, 1958, was a renewal of a prior mortgage which inadvertently had been allowed to lapse.

With respect to petitioners' doubts as to the propriety of combining a motion to dismiss with a motion to strike and a motion to make more definite and certain, it is only necessary to refer to Rule 12, Federal Rules of Civil Procedure.

The petitioners contend that the court may not consider any materials outside of the amended petition in determining the sufficiency thereof. Rule 12(b) permits the court to consider matters outside the pleadings when passing on the question of whether the pleading states a claim upon which relief may be granted, in which case it will be treated as a motion for summary judgment under Rule 56 with all parties being given reasonable opportunity to present pertinent material. Here, while the petitioners would be charged with knowledge of Rule 12(b), they were not actually notified that outside matters would be considered by the Court. The questions raised by the material considered by the Court, including the affidavits filed on behalf of the alleged bankrupt, are decided in favor of petitioners, and petitioners accordingly have no cause to complain that they were not given time to submit counter-affidavits.

The final question is whether the amended petition relates back to the date of the original. This factor is important in view of the alleged bankrupt's contention that the second and third mortgages were but extensions and renewals of the mortgage filed on July 15, 1958, more than four months prior to the filing of the amended petition, although within the four months prior to the filing of the original petition.

The alleged bankrupt concedes that as a general rule amendments to pleadngs are liberally allowed in bank-

ruptcy. He contends that in this case, however, the creditors have attempted to "set forth what was not previously alleged in their original petition" and therefore the amendment should not be allowed. He relies upon Dworsky v. Alanjoy Bias Binding Corporation, 2 Cir. 1950, 182 F. 2d. 803, in which appears the following statement: ". . . we look only to the petition and proposed amendment to determine whether, when considered together, they disclose on their face that in the original petition the creditor set forth, or attempted to set forth, the same preferential transfer or transfers ultimately relied upon." That test is met in the instant case. The original petition plainly attempted to set forth "the same preferential transfer" as did the amended petition, the only substantive difference between the two being the addition in the amended petition of the allegations that the mortgages were given to secure an antecedent debt and that the effect of the mortgages would be to enable such creditors to obtain a greater percentage of their debts than other creditors of the same class. Paragraph 18.26, 2 Colliers, Bankruptcy, pp. 47-49 provides: "Amendments to correct a defective statement of an act of bankruptcy are allowed in the bankruptcy court's discretion, and such amendments generally relate back to the date of the filing of the original petition when they set up no new act of bankruptcy and when the original petition contains a reasonably definite statement to which the amendment may relate. Thus an amendment will be permitted to allege the debtor's insolvency, where insolvency is an essential element of the act of bankruptcy. The court will also permit an amendment to specify the person to whom the fraudulent or preferential transfer was made, and in case of a preferential transfer, to state that the transfers were made with intent to prefer."

In my opinion it was proper to grant leave to file the

amended petition, and it relates back to the date of the original petition.

Done and dated this 9th day of February, 1959.

W. J. JAMESON,
United States District Judge.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No 17,143

WHITEFISH LUMBER COMPANY,
Appellant;

vs.

INDUSTRIAL SUPPLY COMPANY, et al.,
Appellee.

No. 17,186

November 2, 1961

WHITEFISH PLYWOOD CORPORATION,
Appellant,

vs.

WILLIAM L. ROYER, TRUSTEE,
Appellee.

UPON APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA

Before: POPE, MERRILL and DUNIWAY, Circuit Judges. PER CURIAM:

These two separate appeals involve involuntary bankruptcy proceedings taken against Whitefish Lumber Company, a corporation engaged in the sawmill and lumber business at Whitefish, Montana. In the first case, the bankrupt appeals from the district court's order

sustaining the adjudication of bankruptcy. In the second case, Whitefish Plywood Corporation, a creditor of the bankrupt appeals from the district court's order appointing an attorney for the trustee in bankruptcy. In both cases we are satisfied that the orders of the district court must be affirmed for the reasons set forth by the district court in unpublished orders and opinions appearing in the records before this court. In one respect, however, we fel that the issues presented, from the point of precedential usefulness, warrant an opinion by this court.

The act of bankruptcy asserted by the petitioning creditors was a preferential transfer by the bankrupt: the giving (on July 15, 1958, and within four months from the filing of the original bankruptcy petition) of a chattel mortgage to secure an antecedent debt. The mortgage was given in renewal of a previous chattel mortgage filed April 26, 1956, as to which the period for filing the statutory affidavit of renewal had expired.[1]

The bankrupt here contends, as it did in the district court, that a mortgage for which the time for renewal has expired nevertheless remains a valid and subsisting lien as between the mortgagor and the mortgagee and is valid against general creditors, as differentiated from lien creditors; that the tardy filing of the renewal affidavit would not, therefore, constitute a preferential transfer. In this respect the bankrupt relies upon Schreiber vs. Colt, 10 Cir., 1935, 80 F.2d 511.

[1] Section 52-305, Revised Codes of Montana, 1947, reads in part: "* * * A mortgage of personal property, executed and filed as hereinbefore provided, ceases to be valid as against creditors of the mortgagor or subsequent purchaser or encumbrancer in good faith, after the expiration of two years and sixty days from the filing thereof, except as hereinafter provided." Section 52-306 provides for the filing of an affidavit of renewal of a mortgage within sixty days after the expiration of two years from the date of the filing of the mortgage.

As the district court pointed out, however, § 60 of the bankruptcy act in a significant respect has been amended since Schreiber was handed down. In 1938 that section was amended to circumscribe the effect of the authorities upon which the court relied in Schreiber. See 3 Collier on Bankruptcy, § 60.42, pages 932-934. Again amended in 1950, § 60(a) (2), 11 U.S.C. § 96, now provides:

> "* * * a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee * * *."

Referring to the period of time between the expiration of the original mortgage and the filing of the renewal affidavit, the district court stated:

> "During that twenty day period, a lien could have been obtained upon the property 'by legal or equitable proceedings on simple contract' which would have been superior to the rights of the mortgagee. It appears accordingly that the new or renewal mortgage was a transfer within the meaning of Section 60a of the Bankruptcy Act. In other words, at the commencement of the four-months period the new chattel mortgage was not "perfected" as against liens obtainable by legal and equitable proceedings."

We agree.

In both cases the district court is affirmed.

(Endorsed) Per Curiam Opinion Filed Nov. 2, 1961.

Frank H. Schmid, Clerk.

IN THE

SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1961

No. 736

WHITEFISH LUMBER COMPANY

Petitioner

vs.

INDUSTRIAL SUPPLY CO., PACIFIC POWER AND LIGHT COMPANY, KOLIN MACHINE WORKS, KALISPELL MERCANTILE CO., AND FRANCIS POULSON,

Respondents

BRIEF IN OPPOSITION

TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

IN THE

SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1961

No. 736

WHITEFISH LUMBER COMPANY,

Petitioner

vs.

INDUSTRIAL SUPPLY CO., PACIFIC POWER AND LIGHT COMPANY, ROLIE'S MACHINE WORKS KALISPELL MERCANTILE CO. AND FRANCIS POULSON,

Respondents

BRIEF IN OPPOSITION

TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

Argument

Petitioner seeks a writ of certiorari on the reasoning that the holding of the Circuit Court of appeals for the Ninth Circuit in this case is in apparent con-

flict with the holdings in the Tenth Circuit and the Second Circuit and in conflict with the holdings of this Court in similar cases. This same position and basic argument of petitioner has been repeatedly urged since the inception of this action. It has been overruled and rejected first by the Honorable W. J. Jameson, Judge of the District Court for the District of Montana, by the referee in bankruptcy in this matter, again by Judge Jameson on petition for review, and finally by the Court of Appeals for the Ninth Circuit.

No conflict with holdings of other circuit courts or with any holding of this Court exists in fact. Judge Jameson of the District Court and the Court of the Ninth Circuit gave full consideration to this same theory of petitioner as is readily apparent from their respective decisions. Not only do the cases relied upon by petitioner differ materially in a factual respect from the instant case, both as to the instrument involved and the state statutes applicable or pertinent, but such cases are no longer properly expressive of the law in view of the fact that Section 60 of the Bankruptcy Act has been materially changed from its provisions in 1935. The 1938 and 1950 amendments to Section 60a require completely new rules of law to be applied to a factual situation such as we have in this case which were not called for under the Bankruptcy Act prior to those amendments. The District Court and the Circuit Court have applied such rules. Petitioner has cited no cases decided since these amendments, which are in conflict with the holdings in this case under the law as it now is expressed in Section 60a.

The fundamental question in this case, clearly recognized by the District Court and by the Circuit Court, is whether the giving of a new or "renewal" mortgage

constitutes a preferential transfer as defined in Section 60a where such mortgage is given and filed after the expiration of time specified in the Montana statutes for a chattel mortgage to be effective as against creditors or subsequent purchasers or incumbrances in good faith. It is admitted that such a renewal mortgage was given in this case and that it was filed with the proper county official under Montana law "within four months before the filing—against him (the bankrupt) of the petition" in this case.

We feel that the District Court and the Circuit Court adequately and correctly analyzed the pertinent portions of Section 60a of the Bankruptcy Act and the appropriate statutes of the State of Montana (Sections 52-305 and 52-306, Revised Codes of Montana, 1947, see petition, page 5) and that anything that we might add in this brief on that question might well be cumulative only and surplusage.

Under Montana law the "transfer" became "perfected," as defined in Section 60a(2) when it was filed. The original mortgage "ceased to be valid as against creditors of the mortgagor • • • " under Section 52-305, R. C. M., 1947, when no affidavit of renewal was filed within the proper time. Approximately twenty days later a new mortgage was filed so as to create a lien on the bankrupt's property. During that twenty-day period, it is apparent that any creditor could have obtained a lien on such property by "attachment, garnishment, execution, or like process • • • " such as is defined in Section 60a(4) of the Bankruptcy Act. However, after the new mortgage was filed, then under Montana law "it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee," (Sec-

tion 60a(2). This is precisely the type of "transfer" intended to be described by the 1950 amendments to Section 60. We respectfully refer the Court to that portion of the District Court's opinion appearing on pages 23 through 25 of petitioner's petition and the language of the Circuit Court on page 31 wherein these matters are fully discussed.

Petitioner maintains that it should be necessary for the bankruptcy court, in a case of this kind, to determine whether the Montana statute above cited was of such nature to give the mortgagee "some security" even though the filing period had expired, or whether the failure to renew the mortgage within the statutory period rendered it absolutely void. (Petition, page 9).

In urging this position, petitioner completely overlooks and disregards the specific language of Section 60a(2) of the Bankruptcy Act. The words used in that section in referring to the time a transfer of property "shall be deemed to have been made or suffered" establish such time with complete certainty. It is "when it became so far **perfected** that no subsequent lien • • • could become superior to the rights of the transferee." (Emphasis supplied).

Thus it is the time of **perfecting** the lien that is all-important. That is now the time that must control the determination as to whether the transfer is one described by Section 60a of the Act if the other requisite elements are present. And under the Montana statutes above cited the time of the filing of the new mortgage governed its effectiveness since the old or prior mortgage had then ceased to be valid "as against creditors of the mortgagor" and others under the very specific provisions of Section 52-305, R. C. M., 1947, set forth on page 21 of the petition herein.

Whether or not the old or prior mortgage continued

to be effective, after the filing period expired, as between the parties to the mortgage, is of no concern to the bankruptcy court. To the extent that it remained effective between such parties, the mortgagee had "some security." But since a general creditor could have then obtained a lien "by legal or equitable proceedings on a simple contract," as defined in Section 60a(4) of the Act, which lien would have "become superior to the rights of the transferee," and could not have done so after the filing of the new mortgage, then such filing of the new mortgage constituted accomplishment of a preferential transfer as defined in Section 60a.

Petitioner makes reference to "windfalls" realized by general creditors on the expiration of the statutory filing period, and to the "injustice" which results from the decisions of the lower courts in this matter.

It should be noted that it is not the mortgage-transferee who is complaining here but the mortgagor who continues to owe the debt reflected in the mortgage. It should also be noted that the mortgagee had the means within its power to keep the original mortgage alive had it desired to do so. There may have been any number of reasons why it did not file a renewal affidavit. We are not here concerned with such speculation nor should it be used as a reason for granting certiorari in this action.

Conclusion

There being no conflict between the decision of the Court of Appeals in this matter with any decision of another court of appeals on the same or even similar matter, and the decision of the Court of Appeals

in this matter not being in conflict with any decision of this Court on the pertinent provisions of the Bankruptcy Act, no special or important reasons exist for the granting of a review herein on a writ of certiorari and the petition filed herein should be denied.

Respectfully submitted,

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